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SENSITIVE

STATE FOR EB/ESC AND EAP/MTS  
STATE PASS USAID FOR AA/ANE, AA/G  
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DOE FOR TOM CUTLER  
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TREASURY ALSO FOR OASIA  
USDOC FOR 4430 ITA/MAC/ASIA & PAC/KOREA & SE ASIA/ASEAN

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TAGS: [ENRG](#) [EPET](#) [PGOV](#) [EAID](#) [RP](#)

SUBJECT: APEC Amb Michalak Meeting with Energy Secretary

SENSITIVE BUT UNCLASSIFIED - NOT FOR INTERNET - PROTECT  
ACCORDINGLY

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Summary  
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¶1. (SBU) Energy Secretary Lotilla told Ambassador Michalak on March 15 that the privatization of National Power Corporation (NPC) generating plants will move forward when the Manila Electric Company signs a contract soon to purchase NPC's electricity. The Philippines mandated ethanol and coco bio-diesel use in vehicles within two years to reduce oil imports, but lowered ethanol duties to facilitate imports with a lack of local processing. Michalak noted APEC Energy Group efforts to promote conservation, alternative energy, and information-sharing in the region. Mindanao faces a near-term power shortage but new plants and more rainfall may prevent a power crisis that would undermine peace and stability dividends. The regulatory commission is promoting investor confidence by rationalizing prices for transmission and distribution and making changes automatic. End Summary.

¶2. (U) Participants - USG: Ambassador Michael Michalak, Charg d'Affaires Paul Jones, Econoff Cleveland Charles. GRP: Energy Secretary Raphael Lotilla.

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Power Company Needs Contracts to Sell Plants  
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¶3. (SBU) Lotilla admitted privatization of the National Power Corporation (NPC) had stalled, and identified the lack of transitional supply contracts as the primary reason investors were unwilling to buy power plants. The Manila Electric Company (Meralco), which distributes 75% of Luzon's power, is reluctant to contract from NPC because it is already committed to buying from many independent power producers (IPP). Open access would leave it with numerous stranded costs. Lotilla said the Lopez family controlling Meralco owned several IPPs, complicating the negotiations. He said the government would not intentionally target Meralco just because some Lopez members did not support President Arroyo. The GRP

is a major stockholder in Meralco, he noted, and would lose money if the company suffers financially. He said NPC must be allowed to sell directly to those requiring one megawatt and more, such as companies like Intel, which uses 9-10 megawatts (mw). This would benefit industry, improve investor sentiment, and generate jobs and economic growth. In return, Meralco wants to buy from its own IPPs at contracted levels so it does not pay for unused capacity. Lotilla expected NPC and Meralco to sign an agreement within two weeks.

14. (SBU) Michalak pointed out that power is a regional problem, especially for Indonesia, Thailand, and to some degree Malaysia. APEC is working to integrate discussion and resolution of these issues at the global, regional, and bilateral level. The APEC Energy Working Group is especially active in conservation and alternative fuels, exploring ways to set prices and establish a distribution network for ethanol and other bio-fuels, and cooperate and share information on whether resources available are directed as use for fuel or food.

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Bio-fuels for the Philippine Future  
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15. (SBU) Lotilla noted that USAID is providing assistance in drafting a bill on bio-fuel use that has passed the House and is under debate in the Senate. The GRP is requiring a 5% mix of bio-fuel or ethanol in two years and a 1% mix of coco bio-diesel. The country lowered tariffs on ethanol and increased imports in September 2005 and is now reviving the industry it abandoned in the 1970s when sugar prices skyrocketed.

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After blending, Lotilla noted, there are forex savings of 30 centavos per liter (about 2 and a half U.S. cents per gallon). Coco diesel is still more expensive. But Ford Philippines is becoming the first manufacturer in the region to produce flexi-fuel cars that will take up to 20% ethanol. Lotilla said APEC could promote the use of bio-fuels, minimize costs, and facilitate trade by encouraging the adoption of regional standards for ethanol. The Philippines, he said, had the same standards as California in aromatics and sulfur, but this constraint made RP fuel more expensive than fuel in other markets in the region.

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Reduced Dependence on Oil in Energy Mix  
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16. (SBU) Lotilla responded to a question about the mix of energy sources by noting that the Philippines has reduced the amount of oil generating electricity from 24% as recently as 2000 to just 12-13% today. On Luzon, it has fallen to 1% by maximizing hydropower, coal, geothermal, and natural gas. The Chevron-Shell Malampaya project began producing gas in 2002 and now feeds three power plants generating 2700 mw, about 23% of the country's power. Chevron is expected to spend \$15 billion worldwide on capital expenditures and the Philippines wants a portion of that.

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Meeting the Power Shortage  
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17. (SBU) Charg commented that power disruptions in Mindanao could undermine efforts to achieve sustained peace and stability. Lotilla admitted that among the three grids, Mindanao faced the greatest hurdles to a guaranteed electricity supply. He blamed a recent localized brownout on the distribution cooperative covering an area near a hydroelectric dam. The

cooperative owed the transmission company over one billion pesos because it did not collect payments from reluctant customers and egregious system losses. "It is a governance failure," he said. Overall, Mindanao has little excess capacity after the dry conditions during El Nino reduced hydropower generation to 20% capacity. Mindanao is relying on diesel, bunker fuel, and power barges to meet electricity demand until a 200-mw coal plant is operational in early 2007.

18. (SBU) Lotilla said Luzon will still have overcapacity for several more years, with 10,500 mw of dependable supply and peak use of only 6,500 mw. Power demand is growing by 6% per year in the Visayas so it will face shortages sooner than Luzon, where demand is only growing 4.8%. The Korean company Kepco committed to building a 200-mw coal-fired power plant on Cebu near an existing facility that should be on-line by 2010. Panay Island may get a 100-mw coal plant; Negros may expand its supply with geothermal development and a proposed wind farm. Lotilla said he hoped Mirant would expand production from its own facilities now that it is out of bankruptcy in the U.S. The Energy Department and Mirant have discussed converting the Sual plant to Build-Own-Operate instead of a BOT that transfers the plant to the government in 20 years.

19. (SBU) Nuclear power is too controversial after the expensive construction of a plant in Bataan never came on line, Lotilla commented, adding that an additional 1200 mw, the minimum nuclear output, is excessive for Luzon at present. Lotilla said he was, nonetheless, open to nuclear energy, and the Philippines continues to train scientists in the field. He mentioned that new power plants, especially for coal, would need environmental impact assessments. Ocean thermal is still under research. The GRP hopes more gas or oil will be discovered off Palawan. China is doing some exploration in undisputed waters in the South China Sea. Michalak mentioned that the U.S. Geological Survey has signed an

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agreement to conduct a mineral survey of the Philippines once the GRP approved funding of about \$1 million. Lotilla was impressed that the survey would include on-shore coal and geothermal resources that come under the purview of the Energy Department. Michalak also emphasized that energy security requires an efficient and well-supplied global market and the APEC Energy Working Group continued to highlight the conservation and environment pieces of the energy picture.

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Regulatory Steps Assuage Investor Fears  
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10. (SBU) Lotilla said the country has a long history of energy regulation. The current Energy Regulatory Commission (ERC) has established many guidelines, including a new mechanism to allow transmission and distribution companies the automatic recovery of costs due to fuel and foreign exchange. Previously, they had to wait one quarter before submitting data and then were forced to spread the recovery over years. Now the ERC is looking at the spot market and trying to minimize price volatility, but Lotilla said "we just have to take some risks." The main issue is price -- the ERC only allows 2.50 pesos per kilowatt hour, not enough to attract investors. Transmission bottlenecks exist but only create short-term volatility. Senators may prevent Transco's sale because it makes money, Lotilla said, but it is profitable only because government loans are excluded from its balance sheet. A Department study determined that the country's transmission tariffs are higher than the regional average so the ERC may compel the company to charge less.

11. (U) Ambassador Michalak did not have a chance to clear this cable before departing post.

Jones